

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
M. HEIDI OTTO	:	DETERMINATION
	:	DTA NO. 818778
for Redetermination of a Deficiency or for Refund of	:	
New York State and New York City Personal Income Tax	:	
under Article 22 of the Tax Law and the New York City	:	
Administrative Code for the Years 1989 through 1998.	:	

Petitioner, M. Heidi Otto, 303 North Tower Hill Road, RR1 Box 99, Millbrook, New York 12545, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income tax under Article 22 of the Tax Law and the New York City Administrative Code for the years 1989 through 1998.

A hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York on February 27, 2003 at 10:30 A.M., with all briefs to be submitted by June 27, 2003, which date commenced the six-month period for the issuance of this determination. Petitioner appeared by Jay Oher, CPA, and Marvin Weinstein, CPA. The Division of Taxation appeared by Mark F. Volk, Esq. (Margaret T. Neri, Esq., of counsel).

ISSUE

Whether petitioner has established any errors warranting reduction or cancellation of the tax, penalties or interest asserted as due by the Division of Taxation for the years in question.

FINDINGS OF FACT

1. Petitioner, M. Heidi Otto, did not file New York State personal income tax returns in a timely manner for any of the years spanning 1989 through 1998. In 1998, the Division of Taxation ("Division") commenced an audit of Ms. Otto for such years. By letters dated September 29, 1998 and December 12, 1998, respectively, the Division requested of Ms. Otto copies of her tax returns and canceled checks showing payment of income taxes for the ten years in question. Petitioner did not respond to either of these letters. In addition, the Division sought but was not able to obtain information from the Internal Revenue Service ("IRS") regarding Ms. Otto's income, since she had not filed income tax returns with the IRS for such years.

2. As the result of an internet search, the Division's auditor found a web site which described a business petitioner operated in Millbrook, New York. This business, known as Parc Brook Farms, included a bed and breakfast inn, a thoroughbred horse breeding farm, and a real estate development operation. The auditor contacted petitioner by telephone in January 1999, and was advised that petitioner's accountant would provide the necessary tax returns and records and information for audit. However, such information was never provided, despite repeated requests for copies of petitioner's tax returns and other documents necessary to determine petitioner's income and her tax liability for the years in question.

3. The Division's auditor issued subpoenas to certain banks, including Fleet Mortgage Corp., Litchfield Bancorp and Pawlings Savings Bank, seeking documents and information with respect to mortgages on the Parc Brook Farms property. In turn, Litchfield Bancorp provided documents, including two loan applications signed by petitioner for loans she sought to obtain in 1992 and 1996 with respect to the Parc Brook Farms property in Millbrook, New York.

4. The 1992 loan application reflected the following income and asset information pertaining to petitioner:

INCOME

<u>Item</u>	<u>Gross Monthly Income</u>	<u>Gross Yearly Income</u>
Base Employment Income	\$49,166.00	\$589,992.00
Dividends/Interest	400.00	4,800.00
<u>Rental Income</u>	<u>-----</u>	<u>75,308.00</u>
<u>Total</u>	<u>-----</u>	<u>\$670,100.00</u>

REAL ESTATE OWNED

<u>Property</u>	<u>Market Value</u>	<u>Rental Income</u>
3 Villas in Acapulco, Mex.	\$400,000.00	\$ 74,000.00
Bed and Breakfast	775,000.00	1,308.00
N. Tower Hill Rd. 13.15 acres	450,000.00	-----
<u>N. Tower Hill Rd. 15.00 acres</u>	<u>500,000.00</u>	<u>-----</u>
<u>Total</u>	<u>\$2,125,000.00</u>	<u>\$ 75,308.00</u>

5. The 1996 loan application reflected the following income information:

<u>Item</u>	<u>Gross Monthly Income</u>	<u>Gross Yearly Income</u>
Base Employment Income	\$33,333.33	\$399,999.96
Dividends/Interest	287.21	3,446.52
<u>Other Income</u>	<u>8,823.69</u>	<u>105,884.28</u>
<u>Total</u>	<u>-----</u>	<u>\$509,330.76</u>

6. The auditor noted that, unlike the 1992 application, the 1996 loan application did not include the villas in Acapulco, Mexico among the real estate owned by petitioner. Thus, the auditor assumed that the villas had been sold. However, with no specific sale year or sale information provided by petitioner, the auditor based the sale price for the villas on the listed market value shown on the 1992 loan application (\$400,000.00), and included such amount as income in each of the years during which the sale could have occurred (i.e., 1992 through 1996).

The auditor's report noted that upon presentation of additional information, the calculation would be adjusted so as to include the income (gain), if any, from the sale of the villas only in the year of sale, as appropriate.

7. To calculate petitioner's estimated annual income based on the foregoing information, the auditor used the following methodology and assumptions :

<u>YEAR(S)</u>	<u>METHODOLOGY/ASSUMPTIONS</u>
1989 through 1992	income based on income amounts shown on 1992 loan application.
1993 through 1995	income based on income amounts shown on 1992 loan application, plus a 10 % increase thereto for each succeeding year.
1996	income based on income amounts shown on 1996 loan application.
1997 and 1998	income based on income amounts shown on 1996 loan application, plus a 10 % increase thereto for each year.

8. Using the foregoing information and methodology, the auditor calculated the following estimated income amounts for each of the years in issue:

Year	Base Employment Income	Interest and Dividend Income	Rental Income	Other Income	Income from Sale of Villas	Total Estimated Income
1989	589,992.00	4,800.00	75,308.00	-----	-----	670,100.00
1990	589,992.00	4,800.00	75,308.00	-----	-----	670,100.00
1991	589,992.00	4,800.00	75,308.00	-----	-----	670,100.00
1992	589,992.00	4,800.00	75,308.00	-----	400,000.00	1,070,100.00
1993	648,991.20	5,280.00	82,838.80	-----	400,000.00	1,137,110.10
1994	713,890.32	5,808.00	91,122.68	-----	400,000.00	1,210,821.00
1995	785,279.35	6,388.80	100,234.95	-----	400,000.00	1,291,903.76
1996	399,999.96	3,446.52	-----	105,884.28	400,000.00	909,330.76

1997	439,999.96	4,170.29	-----	116,472.21	-----	560,263.84
1998	483,999.95	4,170.29	-----	128,119.98	-----	616,290.22

9. On April 18, 2000, the Division issued to petitioner a Statement of Personal Income Tax Audit Changes showing New York State and New York City personal income tax deficiencies for each of the years 1989 through 1998 in the following amounts:

YEAR	NEW YORK STATE TAX	NEW YORK CITY TAX
1989	51,939.13	22,397.40
1990	51,939.13	25,742.31
1991	52,297.88	29,361.86
1992	83,797.88	47,201.86
1993	89,074.91	50,190.51
1994	94,879.65	53,478.02
1995	97,602.70	57,099.52
1996	64,262.57	40,044.11
1997	37,864.32	24,483.27
1998	41,702.13	26,982.04

The Statement of Audit Changes also reflected the imposition of interest and penalties with respect to each of the years in issue, and was accompanied by a letter explaining that the income upon which the tax was calculated had been estimated based on information supplied by third parties under subpoena. The letter also advised that petitioner had until May 16, 2000 to submit records to the Division for review. Petitioner did not respond to this statement or accompanying letter, or supply any records for review.

10. On July 17, 2000, the Division issued to petitioner a Notice of Deficiency asserting personal income tax due for the years 1989 through 1998 in the aggregate amount of \$1,042,341.00, plus interest, plus penalties pursuant to Tax Law § 685(a)(1)(A); (b), (i). This notice was based on the calculations underlying the Statement of Audit Changes described above.

11. Petitioner challenged the Notice of Deficiency by filing a request for a conciliation conference with the Division's Bureau of Conciliation and Mediation Services ("BCMS"). This request, dated September 28, 2000 was accompanied by New York State personal income tax returns for petitioner for the years 1989 through 1998. The returns submitted with petitioner's request for conference reported a loss (i.e., negative income) for each of the years in issue.

12. Petitioner opted to have the conciliation conference, scheduled for July 27, 2001, handled via correspondence rather than in person. As agreed to by the conciliation conferee, the auditor and petitioner (and confirmed in a letter dated June 25, 2001), the auditor agreed to meet with petitioner at petitioner's Park Brook Farms premises for three days, spanning July 31, 2001 through August 2, 2001, to review documents. The letter listed certain relevant documents which petitioner was to provide to the auditor in support of the information shown on the tax returns which had been filed at the time of her conciliation conference request.

13. Two Division auditors traveled to petitioner's Millbrook, New York location and spent three days attempting to review some 14 boxes of documents made available to them by petitioner. The auditors were unable to reconcile such documents to the information contained on the tax returns, noting that the documents in the boxes were in no particular order but rather were disorganized and haphazardly filed, included canceled checks and other information apparently pertaining to both business and personal matters, included years other than those in

issue, and in some instances had suffered water damage. Ultimately, the auditors made no changes to the Notice of Deficiency as issued. In turn, by a Conciliation Order date September 7, 2001, petitioner's request was denied and the Notice of Deficiency was sustained.

14. Petitioner appeared and testified at hearing, describing the purchase of the Parc Brook Farms property in 1986 using money loaned from Four Star Living, Inc., an entity in which petitioner claims to have held a 25 percent ownership interest and the title of "International Director." Petitioner's intent with respect to the Parc Brook Farms property was to develop the same by subdivision and construction of luxury homes, and ultimate sale. In 1989, the property was divided into two parcels. Petitioner had sought to subdivide the property into five lots but this request was denied by the local planning board. Ultimately, after a moratorium period, subdivision approval for three lots was granted in 1992. Petitioner described her involvement in all aspects of the attempts to develop and operate the Parc Brook Farms premises, including pursuing subdivision approvals, designing the buildings and overseeing their construction, operating the bed and breakfast, and overseeing the horse breeding operation. The property was owned in petitioner's name and the loan applications were completed in petitioner's name.

15. In addition to Four Star Living, Inc. and Parc Brook Farms, Inc., petitioner alluded, though without significant detail, to her involvement and ownership interests in other corporations, including Sterling Holding Corp., Mauritius Corp., and World Class Leadership and Resources Corp., in each of which entities petitioner allegedly held an approximate 50 percent ownership interest. Petitioner did not have personal checking or savings accounts, asserted that she had no "income," and that all monies were "channeled" through the various corporations. She described the "income" as set forth on the bank loan applications as the

combined income of the various corporations rather than as her income. Petitioner characterized the information on the loan applications as “related to her entities” and not to her personally.

16. Petitioner’s 1992 loan application listed an address for petitioner at 321 East 54th Street in Manhattan, New York. This property was described as a cooperative apartment, which was “lost” in a foreclosure of the entire building in 1992. Petitioner provided no other details concerning this property, the amount of time she spent there in any given year, or the manner in which it was “lost.” Petitioner claimed that she did not live in this property during any of the years in issue, since she was fully involved in her efforts to develop the Park Brook Farms property.

17. Petitioner also described, in limited detail, her involvement in “barter clubs.” In this regard petitioner noted, by example, that the materials for and installation of a hardwood floor would be equal to a certain number of “barter credits,” and that a period of vacation time at the villas would likewise be equal to a certain number of “barter credits.” Petitioner was thus allegedly able to obtain certain materials and labor services at Park Brook Farms in exchange for barter credits. Petitioner also noted, without further elaboration, that Sterling Holdings was the corporate entity through which the barter credits and activities were handled.

18. At hearing, petitioner described the villas in Mexico as originally consisting of one building which was subsequently reconfigured into three rental units. Petitioner acquired the villas by purchase in 1978, and held and rented the units until she sold them to raise cash for the Parc Brook project in 1995. In its post-hearing brief, the Division conceded that the gain from

the sale of the villas should be allocated to the year 1995.¹ Accordingly, the Division removed the \$400,000.00 value it had previously included in its computation of income and tax due for the years 1992 through 1996. For 1995, (the year of sale) the Division recalculated petitioner's income so as to include only the gain on the sale of the villas. As a result, the Division has reduced the amount of tax asserted as due for each of such years as follows:

Year	NYS/NYC Tax Initially Asserted as Due	Revised NYS/NYC Tax Asserted as Due	Amount of NYS/NYC Tax Reduction
1992	\$130,999.74	\$81,659.00	\$49,340.74
1993	\$139,265.42	\$89,925.00	\$49,340.42
1994	\$148,357.67	\$99,017.00	\$49,340.67
1995	\$154,702.22	\$131,267.00	\$23,435.22
1996	\$124,306.68	\$57,966.00	\$66,340.68

SUMMARY OF THE PARTIES' POSITIONS

19. Petitioner maintains that the Division failed to conduct a proper audit, and asserts that she had all necessary records to substantiate the amounts and classification of all of the items set forth on the tax returns submitted at the time of her request for a conciliation conference. In this regard, petitioner claims that she had some 14 boxes in which all of her records for the years in issue were stored, that her accountant went through such records, determined the amount of her items of income, gain, loss and deduction for the years in question, and that as a result of this effort the returns submitted should be accepted as correct. Petitioner maintains that for some period of time following a horse riding accident, she was operating at a diminished mental

¹ Petitioner provided the following information concerning the calculation of gain on the sale of the villas:

Selling Price	\$255,000.00
Cost Basis	\$101,921.00
Accum. Deprec.	<u>52,500.00</u>
Gain on Sale	<u>\$205,579.00</u>

capacity leaving her unable to fully comprehend financial matters and hence at a disadvantage in the audit process. Petitioner does not dispute her failure to file returns within the requisite time limit for any of the years at issue, but asserts that she was fully engaged during such years in attempting to develop the Parc Brook Farms property, including dealing with ongoing difficulties with the local planning board and subdivision limitations as well as attendant severe financial difficulties.

20. The Division, in contrast, asserts that it made every reasonable effort to obtain information from petitioner concerning her income and tax liability for the years in question. The Division goes on to point out that despite repeated requests made to petitioner for information, the only information it was able to obtain came as the result of subpoenas issued to financial institutions. In turn, the Division maintains that its resulting calculations and assertion of a deficiency were appropriate under the circumstances. The Division goes on to point out that even after issuance of the deficiency in this case, two auditors were dispatched to petitioner's location for the purpose of reviewing petitioner's records, including specific records as requested. In turn, the auditors were provided with some 14 boxes of disorganized records, pertaining to both business and personal financial matters for the years in issue and for other years, with no explanation of how such records might be tied into the returns submitted by petitioner. The Division notes that even at the time of hearing, petitioner's current representative admitted that he had not reviewed the contents of the 14 boxes of records, but rather suggested that the Division should simply pursue petitioner's accountant for an explanation of how the records relate to the returns as submitted. In sum, the Division maintains that no records were provided until after the Notice of Deficiency was issued, and that even when certain records

were made available, the same were not maintained or presented in any coherent organized manner such that they could be reviewed and understood.

CONCLUSIONS OF LAW

A. It is well established that a Notice of Deficiency issued by the Division is presumed to be correct until the contrary is established, and the burden of showing that such a notice is incorrect rests upon the petitioner (Tax Law § 689[e]; *Leogrande v. Tax Appeals Tribunal*, 187 AD2d 768, 589 NYS2d 383, *lv denied* 81 NY2d 704, 595 NYS2d 398; *Tavolacci v. State Tax Commn.*, 77 AD2d 759, 431 NYS2d 174). In this case, petitioner has failed to provide such evidence as would support any adjustments or reductions to the Notice of Deficiency, save for that conceded by the Division with regard to the gain on the sale of the villas in Acapulco, Mexico (*see*, Finding of Fact “18”), and thus the notice must be sustained.

B. Petitioner has argued that the Division failed to adequately review her records in their entirety, incorrectly concluded that such records were not in a form susceptible to audit, drew unreasonable conclusions as to the amount of petitioner’s income, incorrectly concluded that petitioner was subject to New York City personal income tax as a resident, and inappropriately imposed penalties. In contrast, however, the record bears out that petitioner failed to file income tax returns for any of the ten years at issue, and that despite the Division’s repeated requests for records and information, petitioner supplied nothing. Ultimately, the Division obtained under subpoena two loan applications made by petitioner, and in turn used the income and asset information shown thereon, as supplied by petitioner to the lending institution, as the basis for determining petitioner’s income and her resulting tax liability for the years in question. Under the circumstances, the Division’s resort to this method of determining petitioner’s income and

her tax liability was clearly appropriate (*see, Matter of Dickinson*, Tax Appeals Tribunal, February 3, 2000).

C. In response to the Division's notice, petitioner submitted tax returns for the ten years in issue. These returns report a loss (i.e., negative income) for each year in question. The returns are allegedly based on a reconstruction of petitioner's income and deductions as undertaken by an accountant hired by petitioner, and allegedly reflect the results of that accountant's review of the checks and other documents contained in the 14 boxes of records.² The Division, in turn, sent two auditors to petitioner's premises for the purpose of reviewing the 14 boxes of records in comparison to the returns submitted by petitioner. Despite spending three days reviewing the contents of the boxes, the auditors were unable to relate the records to the returns or substantiate the amounts set forth on the returns. Rather, the auditors found various records, disorganized and haphazardly filed in the boxes, pertaining to various corporate entities as well as to petitioner. The documents in the boxes covered years other than (i.e., in addition to) those at issue, were in some instances water damaged, and related to both business and personal matters. There was no coherent organization or method of filing such records which would have allowed the auditors to relate the same to the returns submitted. Accordingly, no adjustments were made to the Notice of Deficiency.

D. At hearing, petitioner continued to assert that all of the necessary information and substantiation was contained in the 14 boxes of records. However, such information and substantiation was not provided in evidence at hearing, nor was any explanation or example provided by which one could comprehend how such allegedly complete documentation related to

² Contrary to petitioner's assertions in her brief, the 14 boxes of records were not provided for review and examination "on audit," but rather were only made available *after* the issuance of the Notice of Deficiency.

and supported the returns submitted by petitioner or refuted the results of the Division's computations. Petitioner did provide a transaction listing and a general ledger listing cash receipts and disbursements for the years in issue. However, petitioner did not present the testimony of the accountant who reconstructed her records and prepared the after-the-fact transactions listing, general ledger and tax returns for the subject years, so as to explain the methodology used or identify the specific documents upon which he relied, or even to explain how business versus personal items were distinguished or substantiated. In fact, while alluding frequently to the 14 boxes of documents and their alleged completeness, petitioner's representative admitted at hearing that he had not even looked at the documents in the boxes. Petitioner may indeed have accumulated a great number of documents over the course of the ten years at issue, as well as documents for years both prior to and after those in issue. Ultimately, however, the record does not support petitioner's claim that she maintained, in a manner subject to review and verification as required, adequate records of her items of income, gain loss and deduction for any of the years in issue (Tax Law § 658[a]; 20 NYCRR 158).

E. As to petitioner's complaint that the Division incorrectly imposed New York City personal income tax against her, it remains that petitioner herself informed the Division that she had owned a cooperative apartment in New York City at 321 East 54th Street before as well as during at least some portion of the audit period. Petitioner listed this apartment as an asset (real property interest) on the bank loan application, and continued to own the premises until at least sometime in the mid-1990s. Petitioner also stated that she maintained an office in New York City in connection with her employment position as an International Director of Four Star Living, Inc. Under these circumstances, the Division was justified in concluding that petitioner was properly subject to tax as a resident of New York City. In turn, petitioner's testimony

concerning her loss of the cooperative apartment as the result of a foreclosure of the entire building at some point in 1992 (*see* Finding of Fact “15”) was vague and unconvincing.

Petitioner offered no documents concerning such foreclosure or the loss of the apartment nor any specific information concerning the amount of time she spent in New York City during any of the years at issue. Under these circumstances, petitioner has failed to establish that she was not subject to tax as a resident of New York City or that the Division’s imposition of tax on such basis was improper.

F. Finally, the imposition of penalties was proper and is sustained. Petitioner failed to file tax returns for any of the ten years in issue. Furthermore, petitioner failed to maintain or make available records from which her income and her tax liability could be determined.

G. The petition of M. Heidi Otto is hereby denied and the Notice of Deficiency dated July 17, 2000, as reduced only insofar as to reflect the Division’s adjustment based on the sale of the villas in Acapulco, Mexico (*see* Finding of Fact “18”), together with penalty and interest, is sustained.

DATED: Troy, New York
November 26, 2003

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE